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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

**DOCKETED**

JEFF HATCH-MILLER, Chairman  
WILLIAM A. MUNDELL  
MARC SPITZER  
MIKE GLEASON  
KRISTIN K. MAYES

JAN 20 2005

JAN 24 2005

DOCKETED BY

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IN THE MATTER OF THE APPLICATION OF  
ARIZONA WATER COMPANY FOR AN  
ACCOUNTING ORDER AUTHORIZING THE  
DEFERRAL OF CAPITAL COSTS AND  
EXPENSES INCURRED BY ITS WESTERN  
GROUP SYSTEMS RELATED TO ARSENIC  
TREATMENT.

DOCKET NO. W-01445A-04-0498

DECISION NO. 67518

**ORDER**

Open Meeting  
January 11 and 12, 2005  
Phoenix, Arizona

**BY THE COMMISSION:**

On July 8, 2004, Arizona Water Company ("Arizona Water" or "Company") filed an application with the Arizona Corporation Commission ("Commission") for an accounting order authorizing the deferral of capital costs and expenses incurred by the Company's Western Group systems related to arsenic treatment.

On October 4, 2004, the Commission's Utilities Division Staff ("Staff") filed a Staff Report recommending approval of the application subject to certain modifications and conditions.

On October 13, 2004, Arizona Water filed a Notice that it disagreed with Staff's recommendation to deny the Company's request to record arsenic treatment facilities in a deferred debit account. Arizona Water indicated that it would likely file written testimony or object to Staff's recommendation.

A Procedural Order was issued on October 13, 2004 directing Arizona Water to file a response to the Staff Report by October 29, 2004 and indicate whether the Company seeks a hearing on the application.

On October 29, 2004, Arizona Water filed a Response to the Staff Report explaining why the Company disagrees with Staff's proposed deferral methodology. The Company requested that its

1 objections be considered without a hearing.

2 On November 3, 2004, a Procedural Order was issued directing Staff to respond to Arizona  
3 Water's objections by November 19, 2004.

4 On November 19, 2004, Staff filed a Responsive Staff Report reiterating its prior position and  
5 explaining why it disagrees with the Company's objections. Staff stated that it is not requesting a  
6 hearing on this matter.

7 \* \* \* \* \*

8 Having considered the entire record herein and being fully advised in the premises, the  
9 Commission finds, concludes, and orders that:

10 **FINDINGS OF FACT**

11 1. Arizona Water provides water service to customers in 18 water systems in three  
12 separate groups, Northern, Eastern, and Western. The Company's Western Group consists of the  
13 Casa Grande, White Tank, Stanfield, and Ajo systems, which provide water service to approximately  
14 26,000 customers.

15 2. The United States Environmental Protection Agency ("EPA") has issued regulations  
16 that require water systems to reduce arsenic maximum contaminant levels ("MCL") from 50 parts per  
17 billion ("ppb") to 10 ppb, effective January 23, 2006. Arizona Water estimates that it will incur  
18 actual capital costs of \$13.6 million and annual operation and maintenance ("O&M") costs of \$2.1  
19 million for the Company's Western Group systems to comply with the EPA arsenic reduction  
20 regulations.

21 3. The Company seeks an accounting order in this proceeding authorizing the deferral of  
22 capital costs and expenses it expects to incur before those costs can be recognized in rates. An  
23 accounting order is a rate-making mechanism whereby a regulatory commission provides specific  
24 deferral authorization to treat costs in a manner that differs from generally accepted accounting  
25 principles. Such a deferral mechanism, pursuant to an authorized accounting order, is permitted  
26 under National Association of Regulatory Commissioners ("NARUC") Uniform System of Accounts  
27 ("USOA") guidelines.

28 4. Arizona Water seeks an accounting order authorizing it to: (1) defer recognition of the

1 purchase cost of arsenic treatment facilities or the lease capital costs for leased facilities until an  
2 Arsenic Cost Recovery Mechanism (“ACRM”)<sup>1</sup> is authorized for the Western Group; and (2) defer  
3 up to 12 months of qualifying recoverable O&M expenses for inclusion in an ACRM. Given the  
4 timing difference between the rate case filings of the Northern and Eastern Groups, and the Western  
5 Group, absent an accounting order permitting deferral of incurred costs Arizona Water would be  
6 precluded from recovering legitimate arsenic treatment costs.

7 5. In Decision No. 66400 (October 14, 2003), the Commission authorized an ACRM for  
8 the Company’s Northern Group. An ACRM for Arizona Water’s Eastern Group was approved in  
9 Decision No. 66849 (March 19, 2004). The Northern and Eastern Group ACRMs were approved  
10 within the context of rate cases, but Arizona Water seeks a deferral of qualifying costs in this  
11 proceeding because its Western Group will incur arsenic treatment costs prior to the consideration of  
12 the Company’s pending Western Group rate case, which was filed on September 7, 2004 (Docket No.  
13 W-01445A-04-0650).

14 6. In Decision No. 66400, the Commission identified the following specific types of  
15 costs for which Arizona Water is permitted to seek recovery through the ACRM: capital costs for  
16 construction of arsenic treatment facilities; leased equipment costs; and “recoverable” O&M costs<sup>2</sup>.  
17 Staff points out that a principal factor in Staff’s recommendation for approval of the Northern and  
18 Eastern Group ACRMs was the potential for arsenic treatment capital and operating costs to have a  
19 detrimental financial effect on Arizona Water. In the Staff Report in this proceeding, Staff expressed  
20 the same concerns regarding the Western Group absent approval of arsenic treatment deferrals (Initial  
21 Staff Report, at 2-3). However, Staff disagrees with Arizona Water’s proposal to record purchased  
22 arsenic treatment facilities in a deferred debit account because, according to Staff, such treatment  
23 “effectively provides for authorization of recovery, not simply deferral for future consideration of  
24 recovery, of depreciation expense on the arsenic treatment facilities incurred during the deferral  
25 period” (*Id.* at 3). Therefore, Staff recommends an alternative treatment whereby the depreciation

26 <sup>1</sup> An ACRM is a step increase procedure that allows the Company to earn a return on arsenic treatment facilities capital  
27 costs, and certain qualifying O&M costs, after submitting required documentation to verify that the treatment facilities  
have been installed and are operating.

28 <sup>2</sup> Recoverable O&M costs were defined as ‘media [filter] replacement or regeneration costs, media replacement or  
regeneration service costs, and waste media or regeneration disposal costs’ (Decision No. 66400, at 5-6).

1 expense on the arsenic treatment facilities would be deferred.

2 7. As indicated above, Staff recommends approval of an accounting order subject to  
3 certain conditions that Staff believes are consistent with the treatment accorded Arizona Water in its  
4 Northern and Eastern Group ACRM cases. Staff's recommendation for approval of an accounting  
5 order for Arizona Water is subject to the following conditions:

- 6 a) Depreciation expense for the actual cost to purchase each arsenic  
7 treatment facility may be deferred for a period not to exceed 12  
8 months;
- 9 b) The actual lease capital costs (standby fee) for each leased arsenic  
10 treatment facility may be deferred for a period not to exceed 12  
11 months;
- 12 c) Leased capital costs must meet the following criteria to be eligible  
13 for deferral: the costs recorded for leased equipment must be  
14 broken out by payment into three separate components (the  
15 lessor's equipment construction costs, recoverable O&M costs, and  
16 other O&M costs); and the lessor's embedded interest rate must be  
17 stated;
- 18 d) O&M expenses eligible for deferral are limited to the following:  
19 media replacement or regeneration costs; media replacement or  
20 regeneration service costs; and waste media or regeneration  
21 disposal costs for each of the systems for a period up to 12 months;
- 22 e) No property taxes associated with arsenic recovery plant shall be  
23 deferred; and
- 24 f) No deferrals shall be recorded after January 2007.

25 8. In its October 29, 2004 Response, Arizona Water states disagreement with Staff's  
26 proposed deferral methodology based on the Company's assertion that Staff's recommendation would  
27 unfairly reduce the Company's arsenic treatment facility rate base, while increasing the amount of  
28 ACRM revenue that customers would have to pay. According to the Company, it is requesting that  
the purchase cost of arsenic treatment facilities be deferred until its first ACRM filing is made, which  
would preserve its investment and would produce a lower ACRM revenue requirement. Arizona  
Water asserts that the USOA discussion of A/C 186 Miscellaneous deferred debits contradicts Staff's  
claim that recording arsenic treatment plant in a deferred debit account would guarantee cost recovery  
of such costs. The Company claims that its proposed methodology would record the purchase cost of  
the arsenic treatment facilities in a deferred debit account but would not recognize depreciation or a

1 return until the first ACRM becomes effective. The Company contends that Staff's recommendation,  
2 on the other hand, would begin recording depreciation, but not a return, as soon as the arsenic  
3 treatment facilities are placed in service. Arizona Water attached a schedule to its Response that the  
4 Company claims supports its contention that recording arsenic treatment costs in a deferred debit  
5 account, as opposed to Staff's proposed deferral of depreciation rather than plant, would result in  
6 ACRM revenue of \$32,413 less per month. Arizona Water states that it discussed the accounting  
7 treatment issues with Staff but was unable to reach agreement.

8         9. Staff filed a Responsive Staff Report on November 19, 2004 reiterating the position  
9 taken in the initial Staff Report. Staff claims that Arizona Water misinterpreted its own analysis.  
10 Staff argues that the Company's analysis shows the net present value of projected cash flows is  
11 greater under Staff's methodology which, according to Staff, means that the Company's return is also  
12 higher under Staff's proposal. Staff concedes that under its deferral recommendation, customer bills  
13 would be higher for the first 12 months; however, Staff claims that customer bills would be lower  
14 during the subsequent 34 years under Staff's methodology (Responsive Staff Report, at 2).

15         10. We agree with Staff that its proposed deferral methodology should be adopted because  
16 it recognizes the appropriate accounting treatment for Arizona Water's arsenic treatment facilities on  
17 a long-term basis. Staff's methodology is consistent with the ACRMs approved for the Northern and  
18 Eastern Groups in which no return on arsenic treatment facilities is recognized until the ACRMs are  
19 in effect, even though the treatment facilities are being depreciated. As Staff points out, the Northern  
20 and Eastern ACRMs can not be replicated for the Western Group because the Western Group will be  
21 required to place arsenic treatment facilities in service before an ACRM is established in its pending  
22 rate case (*Id.* at 2). We believe Staff's recommendation would permit expedited recovery of most  
23 arsenic treatment costs while providing Arizona Water's ratepayers with a measure of protection  
24 against the possibility of over-earning by the Company. We will therefore approve the Company's  
25 application for an accounting order authorizing deferral of arsenic treatment costs subject to the  
26 conditions recommended by Staff, as described above.

27         11. As a condition of approval, Arizona Water shall also be required to prepare and retain  
28 accounting records sufficient to permit detailed review, in a rate proceeding, of all deferred costs

1 related to the arsenic treatment facilities.

2 **CONCLUSIONS OF LAW**

3 1. Arizona Water is a public service corporation within the meaning of Article XV of the  
4 Arizona Constitution and A.R.S. §§40-250 and 40-252.

5 2. The Commission has jurisdiction over Arizona Water and of the subject matter of the  
6 application.

7 3. The cost deferral authorization granted herein does not constitute a finding or  
8 determination that such costs are reasonable, appropriate, or prudent.

9 4. It is in the public interest to allow Arizona Water Company to record the arsenic  
10 treatment facilities costs for its Western Group in a deferred account, subject to the conditions  
11 recommended by Staff as set forth and discussed herein.

12 **ORDER**

13 IT IS THEREFORE ORDERED that the application by Arizona Water Company for an  
14 accounting order authorizing deferral of arsenic treatment costs is approved, subject to the conditions  
15 and requirements recommended by Staff, as described herein.

16 IT IS FURTHER ORDERED that the cost deferral authorization granted herein does not  
17 constitute a finding or determination that the deferred costs are reasonable, appropriate, or prudent.

18 IT IS FURTHER ORDERED that this Decision shall not be construed as providing Arizona  
19 Water Company any relief through rates with respect to the ultimate recovery of the above-authorized  
20 cost deferrals.

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IT IS FURTHER ORDERED that Arizona Water Company shall prepare and retain accounting records sufficient to permit detailed review, in a rate proceeding, of all deferral costs recorded as authorized herein.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 20<sup>th</sup> day of Jan., 2005.

BRIAN C. McNEIL  
EXECUTIVE SECRETARY

DISSENT

DISSENT

DDN:mj

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